RICHARD RUSSELL'S **DOW THEORY LETTERS, INC.**

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September 10, 1980 **LETTER 791**

Aug. 29, DJIA 932.59; PTI 1290; A-D ratio –17.19
Sept. 5, DJIA 940.96; PTI 1303; A-D ratio –16.41

THE PICTURE: I became fascinated with Wall Street back in the 1940's because I realized (after long and frustrating study) that THE MARKET TELLS THE STORY. The market represents the sum total of what **everybody** knows about anything that can influence or affect America's corporations. And I'll stack up the market's knowledge against the knowledge of the Federal Reserve Board, the Department of Commerce or any single man or group of men.

Wall Street can take months to make up its mind, or it can change its mind in a day. For instance, it's worth noting that all through the 1920's the market was insisting that the primary trend was bullish–right up to September 3, 1929. On September 4 stocks turned down, and at that point (although almost no one guessed it) Wall Street had "changed its mind." During late-October of that year the market crashed, and it was here that a few seasoned observers suspected that a great bear market was in progress. Investors in 1932 looked back on the events of the past three years and realized that the correct procedure was not to argue with the market's verdict–the correct procedure was to get in line with what the market was saying.

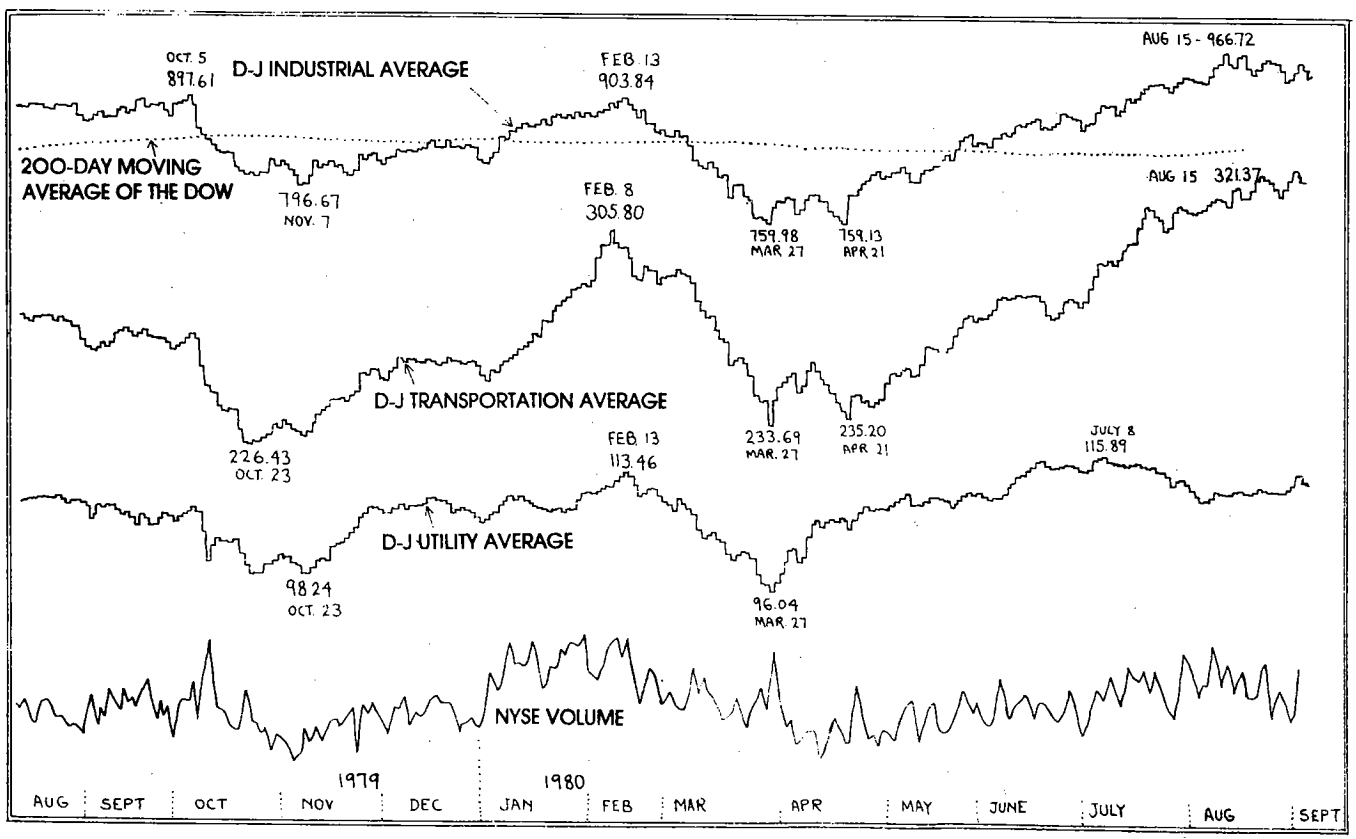
What is the market saying today? The market is saying that the primary trend is up but that there are a few "flies in the ointment." One is that momentum is slowing down. For instance, the D-J Industrials actually lost 2.73 points between the last day of July and the last day of August. But that's all right, because the angle of ascent from March to August was unsustainable anyway.

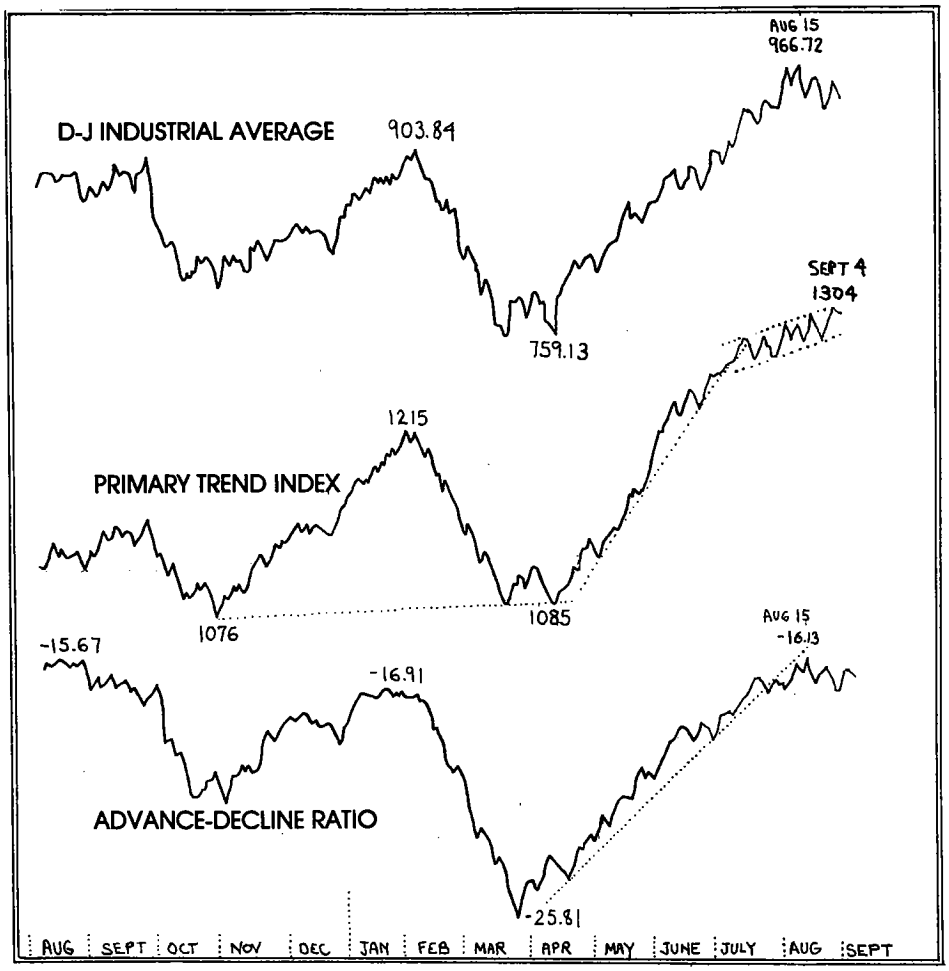
FRONT PAGE NOTES: Reagan's worst political enemy is clearly Reagan. His lengthening list of boo-boo's could hurt his image and his pulling ability at the polls. Personally, I believe Reagan is making a major mistake in debating Carter. Carter is good at impromptu speaking, quick-minded, and possessed of a very retentive memory.

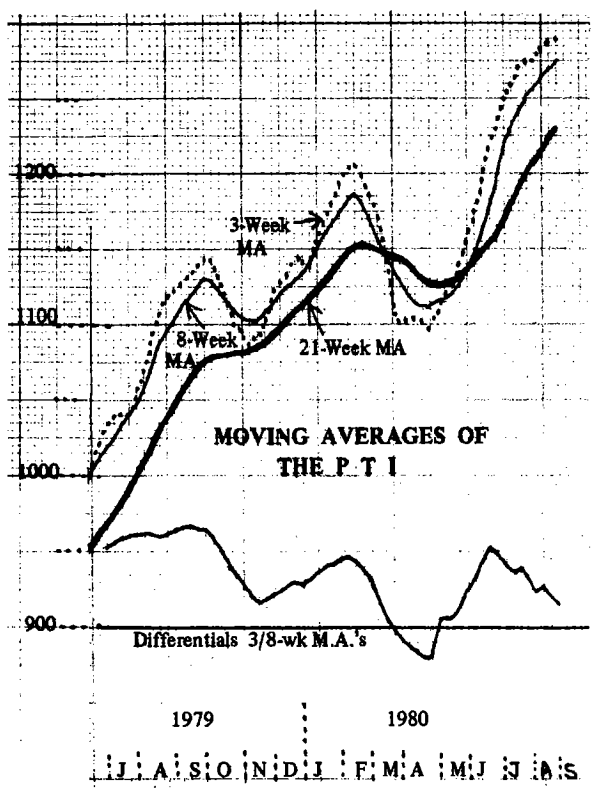
Carter's basic fiscal conservatism is showing. Despite the deficits, Carter does not really want to spend, and I believe the Fed is under orders from Carter to "cool it" as much as possible. Federal Reserve Credit has not expanded since last December, a fact which few people realize. If Carter is reelected, my bet is that many of the proposed military programs will be pared or cancelled. Note that Carter's promised tax cut will not take place until next year (at which time he can call the cuts off if the economy is picking up).

Carter is basically guided by one thing–votes. He has concluded that inflation is the biggest problem in the minds of Americans. Therefore, he is opting for anti-inflation above all. My military advisor, Mr. X, tells me that if Carter is reelected, we face a military disaster as Mr. X is convinced that Carter would go back to his "accomodation" approach towards Russia (rather than an approach through strength).

Another important item to watch is the recent non-confirmation by Industrials. Industrials recorded their high of 966.72 on August 15. After a slight decline, Transports (see chart below) rallied to a record new high of 317.73 on August 22. A 4 day decline followed, and on September 3 Transports hit yet another







record high of 329.15. Again, Industrials failed to better their 966.72 peak. As of this writing the drama is still being played out—and the non-confirmation still remains. Failure to better 966.72 could be an early indication of trouble, while bettering that level would be the Dow Theory's way of saying "all clear—and up."

From the standpoint of my 233-day stock market cycle studies, the Industrials hit their high on August 15—exactly at the peak of the bull segment of the cycle. We are now in the bearish segment, and this period should last until the end of October. How the market fares during the bearish period should tell us alot about its strength.

The Bond and Utility Averages exerted a negative influence on the stock market all during the June to August period. But the Utility Average struck a low of 108.91 on August 5, and since then it has trended higher. The bonds continued to decline, and by September 1 the D-J 20-Bond Average had given back over half its earlier 1980 gains. As bonds slumped, interest rates rose, and this is the negative pressure with which stocks have had to contend.

How about the Primary Trend Index (PTI), what is it saying? For the benefit of new subscribers, let me repeat that I discovered (or invented) the PTI back in 1971, and I have plotted this Index daily ever since. After 11 years of computing and following the PTI, I have come to place more and more faith in its reading. I'll go further and say that most of my mistakes since 1971 have been made by my arguing with, or refusing to believe, what the PTI was saying. It's seldom that a man is humiliated by his own invention, so now when the PTI says something, I don't protest, or argue—I just "get in line."

The steep uptrend which began for the PTI in April (see daily chart) was broken on July 24. Since then, I must say I have been surprised by the continuing strength in the PTI. In the past, when a 3 or 4 month rising trendline in the PTI was ruptured, a declining channel was soon formed. Not so this time, at least as of this writing.

As you can see, a new channel has appeared in the PTI, but the current channel has a much shallower rate of ascent than the April to July channel. As long as the PTI holds within or above this second rising channel, the Index will be saying that the bull forces arein command. And as I've said so many times before, no decline of any real significance is going to materialize until the PTI turns down on a trend basis. That may begin on the day this Letter is mailed, or in a week or a month—but it has not occurred yet. In fact, on September 3 the PTI rose to a record high of 1306.

Note the jagged path of the PTI from mid-July to the present. What this saw-toothed pattern tells us is that during this period the bullish and bearish forces were constantly jockeying for position. Nevertheless, in instance after instance the bullish forces proved the more powerful.

At the bottom of the chart we see the advance-decline ratio, a proxy for the entire NYSE. The A-D has acted weaker than the PTI on a short-term basis. Moreover, the A-D is still below its August, 1979 peak, and that peak is in turn below the September, 1978 peak. Thus a very long-term non-confirmation between price and breadth exists. But I will stay with the PTI in assessing

the overall trend, even though the A-D ratio is issuing long-term warnings.

As a further help in assessing the PTI, I include my chart of the 3 (exponential) moving averages of the PTI. The picture here is of weakening bullishness, even though all three moving averages are holding in the bullish position. At the bottom of this chart you can see that the differential between the 3-week and the 8-week MA's is narrowing, and this means that the rate of ascent of the PTI is declining(the peak rate was recorded in mid-June). Declining momentum is a negative, but the first true bearish indication on this study would be a drop by the 3-week MA below the 8-week MA. This has not occurred yet.

MONEY NEEDED: If anyone has written more about debt and deficits than I have, I don't know who it can be. I've discussed the ominous implications of the debt build-up, I've included charts showing the effects of compounding interest on the debt, I've warned that steady debt increases are exponential in character, and I've stated repeatedly that all debt must ultimately be paid off or cancelled (debts can be cancelled through bankruptcy or via inflation). Yet the current mountain of debts continues to grow.

The record interest rates of early-1980 were brought on by surging demand from business, and from consumer demand (mostly for mortgage loans and installment debt). But the rising interest rates of today have been brought on for another reason. That reason is illiquidity. Everybody needs money to stay alive in this system. The money is needed for living expenses, for business expenses, it is needed to service the debts, and for carrying inventory.

I want to state this again for new subscribers. The US is now in the throes of an exponential rise in the cost of servicing its $5 trillion in assorted debts. The rate on T-bills is now 9.7%. At 9.7% money doubles in 8 years,, it quadruples in 14 years. The prime rate is now 11.5%. At 11.5% money doubles in 7 years, it quadruples in less than 13 years. In order to support these rates of interest, this nation must either inflate at comparable rates, or our economic growth must rise at the same exponential rate.

It's very possible that we may inflate at those rates, but I don't see real growth at anything like those rates. That means (as I've been saying for the last three years) that the US must "inflate or die." There is no middle ground, no stability any more – not with $5 trillion in debt hanging over our heads.

People are talking about "getting interest rates down." Others tell me that "interest rates will collapse during this recession." Forget it. There's only one fundamental way of getting interest rates down in our economy. That is through debt liquidation. In other words, you must get rid of the debt, reduce to manageable levels. You do that by liquidating the debt, paying it off, and by sending those who can't survive through the bankruptcy courts. Following the liquidation, total debt will be down, servicing charges will be down, demand for money will be way down, and interest rates will sink to low levels.

That's nature's way of getting interest rates down. Any other course entails Government manipulation, lying, juggling the figures, holding off the wolves, and above all – inflation.

The various markets are now in a quandary. The July leading indicators show a record jump of 4.6%. Is the turn coming? Is this the worst of the recession that we are now seeing? If so, then the demand for money will increase again, and interest rates will head higher. If that happens, you can forget about the already staggering housing industry, you can be skeptical about any big car-buying spree, and you can figure that consumers (who are still paring down their installment buying at a record rate) will be buying very close to the vest.

On the other hand, if the rise in the leading indicators is a deception, if business is not really heading upward again, then stag-flation will be the victor, and we'll all try to hang on until Washington hops in with its next round of surprises (or disasters) or possibly a combination of both.

What about the possibility of deflation? In my opinion, deflation will only materialize as a result of a mistake, a miscalculation on the part of the authorities. Remember, it takes more and more credit to produce less and less GNP in the US (this has been the case for the past 30 years). In today's economy, too little inflation is actually DEFLATIONARY and it is possible that stag-flation could give way to deflation. This would be the great shock which so many hard-money analysts are warning about. The odds are against it's occurring – but it could happen (particularly under a Fed that does not understand the exponential character of inflation).

The bond market is now in a position where it "should" rally. Prices have been coming down (with interest rates rising) ever since mid-June. Last week the money markets tried to rally, but the rally was interrupted and appeared a bit tentative. I noticed that the D-J Municipal Bond Average also hit a record high yield of 9.7% last week (this is a tax free yield). The sagging muni market could be putting a damper on the whole money market. It could also be telling us something about the shaky state of our cities, counties, and states.

Let me put it this way, for the many subscribers who have been calling me about interest rates. IF the money markets can't rally, in the next few weeks, then something is wrong. Bonds should be ready and able to rally, but those muni yields are ominous. My advice: stay in short maturities.

PHILOSOPHY: *"Isao Inokuma, Japanese and World Judo champion, stated that for all his wins and sixth-dan rank, he only knew about 50 throws. As those who fought him will attest, however, he knew them very well, and he was able to apply them at the right moment. He become a winner by adhering to basics."* (from Black Belt magazine, Oct., 1980).

Inokuma learned and was practicing something that every investor should fully understand. That is that the key to success in investing is to identify those areas in which you are particularly interested – and then to become expert in those areas. I know market men who follow many areas: stocks, bonds, arbitrage, commodities, gold, you name it. But I know very few investors who do well in more than a few categories. Most of the real winners make their money in one or two areas. But in those one or two areas they are expert!

To use a personal example, I like the closed-end funds. I understand them, I like the fact that they usually sell at a discount, I like the fact that they offer high yields plus (most of them) capital gains disbursements. I feel comfortable with them. Yet, most investors believe these funds are stodgy, cumbersome, uninteresting and difficult to understand.

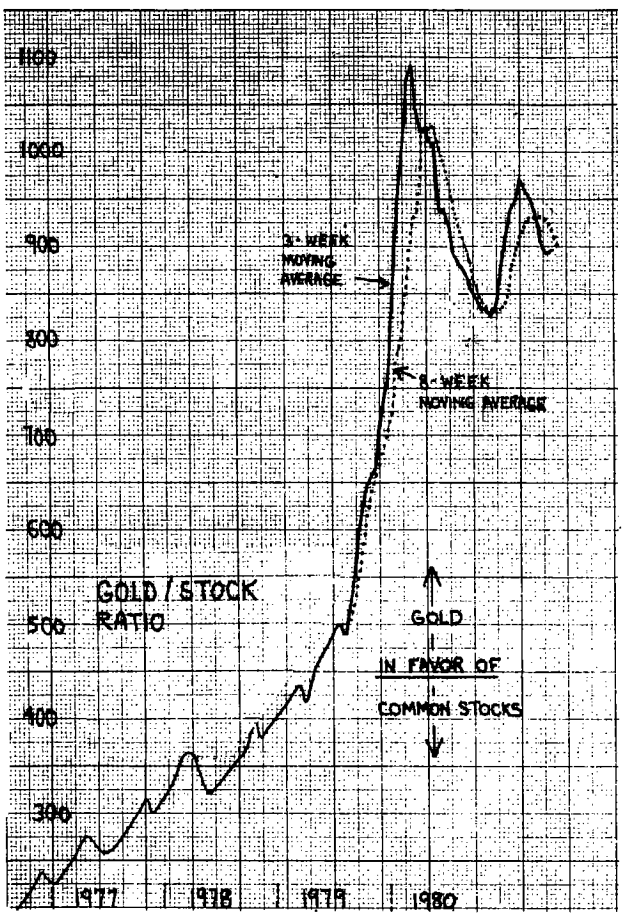
One of the commonest stories I hear runs like this: "I was pretty much in T-bills and stocks, and I kept hearing about the fortunes that were being made in fast-moving commodities. So I got this

trader to take my account. To make a long story short, I lost half my money in three months. I should have stuck to what I knew!"

Recently, a well known real estate man was explaining to a friend of mine why it was an advantage to have some gold. After listening patiently for a full hour, the real estate man thanked the friend and said, "You know, I'm sure you're right, but to tell you the truth I just don't understand gold. I have no feel for it. So I guess I'm doomed to just stay with real estate." I thought to myself, "That man is a professional. He realizes the wisdom in the concept, 'If you don't understand it, skip it'."

Conclusion: You're far better off in limiting yourself to investment areas that you know, like and are comfortable with. Some traders have made fortunes operating in only two or three stocks that they were thoroughly familiar with. Conversely, fortunes have been lost by men who were adventuring in areas in which they were ignorant.

COMPARISONS: I started this Letter with the thesis that "the story is in the markets." Actually, all investments compete with each other. For instance, if you suddenly find yourself with $50,000, do you put it in stocks, bonds, C/D's, coins, paintings, or a house? Robert Salomon of Salomon Bros. has taken on the task of tracking the various investments. Over the past five years (on a compound annual appreciation basis) Chinese ceramics were the winners at 38%. US stamps (see last Letter) were second at 31% per year. Gold was third at 28%. Silver was fourth at 27%. And US coins were fifth at 22% per year. Stocks ranked fourteenth at 6.4% per year.



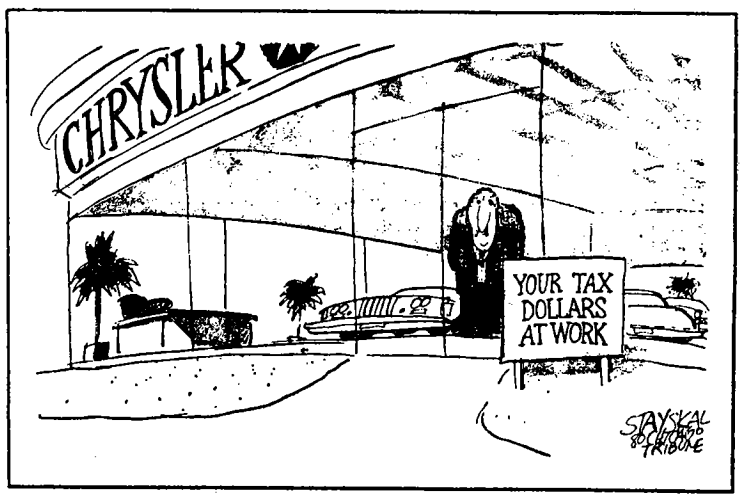
I've been tracking the *ratio* of gold (real money) and common stocks (based on the NYSE Composite of all NYSE common stocks) for some time. I use these two because (1) most readers of these Letters are vitally interested in both gold and common stocks, and (2) both gold and common stocks are liquid and easy to switch in and out of.

There's no guessing with this chart. Each week I compute the ratio of gold to common stocks, and I run this ratio on a 3-week moving average and an 8-week MA. When the 3-week crosses above the 8-week, that's the signal that gold is stronger, and here you should increase your gold position. When the 3-week breaks below the 8-week, common stocks are stronger and you should increase your stock position.

Gold reigned supreme from 1976 to 1980. Gold reached its peak of relative strength in January, 1980. In February a bull signal was given in favor of stocks. In May we got a signal in favor of gold again and this signal lasted through July. On the week ending July 31 the study said "back to common stocks" and that's been the story since.

Late Developments: On the week ending August 28 the 3-week MA hit a low of 880. Last week (September 4) it climbed to 884. Meanwhile, the 8-week MA has dropped to 892. A few more weeks of strength in the 3-week MA will take it above the 8-week MA for a signal in favor of gold again. It's a most fascinating picture.

NOTES & QUOTES: During a WSJ interview, Chrysler's Gerald Greenwald (chief financial officer) was asked about the optimistic profit projections which Chrysler had presented to the Government as part of its bid for Federal aid. Answered Greenwald, "You didn't really take that stuff seriously?" At any rate, Chrysler is now sharply down-grading its profits projections. And the cartoonist are making their usual inciteful comments.



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Jimmy in dreamland: From a recent speech by Carter: "There has not been a President in modern history, including Franklin Delano Roosevelt, and including Lyndon Johnson, who has a better record of support from the Democratic Congress than has Jimmy Carter." (Or is Carter going on the principle that the bigger the lie, the less apt people are to question it?).

* *

Sign of the Times Dept: For the first time in history, the median price for buying an existing home in California went above $100,000 (July figure). What's going to happen, you ask? My answer is that you're going to see *smaller* houses just as you're seeing smaller cars. As the Government budget gets bigger, civilian life gets smaller. If you don't believe it, ask the Poles.

* *

Unbelievable Statistics Dept: Each day 48,000 Chinese babies are born!

* *

Forbes magazine (Sept. 1, 1980, page 72) lists 15 diversified stock funds and provides their record since 1968. The average annual total return on the 15 funds since 1968 is 9.93%. The best rate was 12.1% per year and the worst was 8.1%.

Name	Type	Average annual total return 1968-80
Diversified stock funds		
AMCAP Fund (2) •	load	8.4%
Charter Fund (3) •	load	12.2
Founders Special Fund (3) •	no-load	10.7
General American Investors (3) •	closed-end	8.1
Guardian Mutual Fund (5) •	no-load	8.6
Madison Fund (2)	closed-end	9.3
Mathers Fund (3) •	no-load	9.5
Mutual Shares (5) •	no-load	12.1
Niagara Share Corp (3)	closed-end	8.5
Over-The-Counter Securities Fund (1)	load	12.0
Petroleum & Resources Corp (4)	closed-end	13.1
Philadelphia Fund (2) •	load	8.1
Pioneer Fund (6)	load	8.7
20th Century Select Investors (3) •	no-load	11.0
Weingarten Equity Fund (1)	no-load	8.7

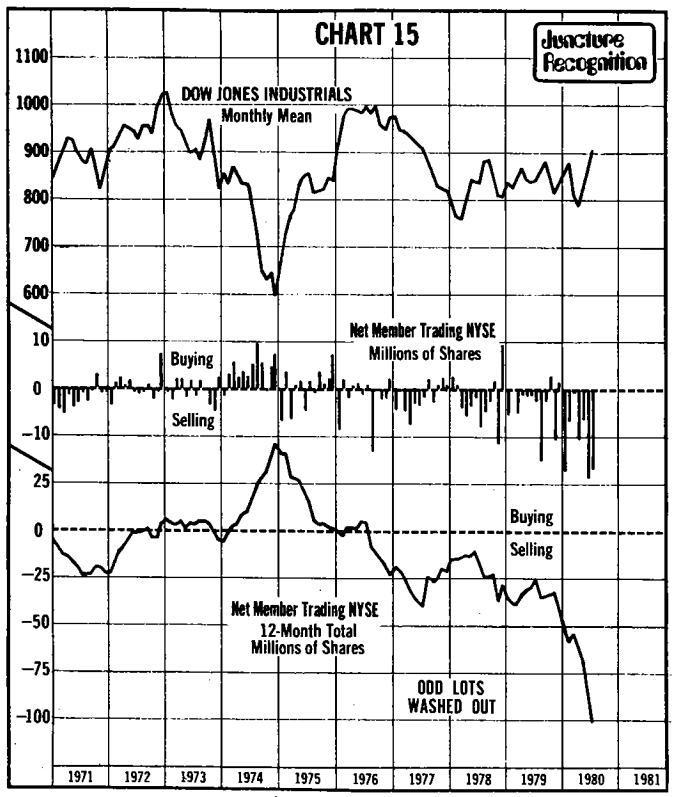
Now 1968 to 1980 was admittedly a difficult period for common stocks, but who is to say that the next 10 years won't be just as difficult–or more so? Treasury bonds of 10 years' maturity are now yielding around 11.5% or almost 2% more than the average 12 year return on these 15 outstanding, cream-of-the-crop funds.

The question: are stocks cheap when you can get a government guaranteed return which is 2% higher than the average rate of return on well-managed funds? My answer is no, they are not. This means that in order to outperform the yield you can now receive on Treasury bonds, you must outperform the funds through your own stock trading or investing by about 2% on a year after year basis. Can this be done? Yes, but not by many, and not without a great deal of expertise.

INCREDIBLE: The accompanying chart tells an incredible story. The chart is courtesy of Juncture Recongnition, Box 1209, Pompano Beach, FL 33061. What the chart shows is the monthly transactions of members of the NYSE. Normally, these members will tend to anticipate important market tops and bottoms. Thus you see the net buying during 1974, and this was obviously buying as the members recognized that the market could not go down forever, and it was therefore (starting in 1974) time to begin accumulating for the bottom. By the time the bottom came in late-1974, the members had accumulated a large amount of stocks.

This stock was gradually distributed during the rise to the 1976 high. During 1978 through 1979 the members continued selling stock but at a steady rate. Now comes the interesting part. During mid-1979 to the present the members stepped up their selling to the largest totals I have ever seen. As Bill Bretz (editor of Juncture Recognition) put it, "They (the members) are so bearish now that only a major market collapse would confirm the correctness of their attitude."

CONCLUSION: Nothing works all the time on Wall Street. There's an old adage, "Go with the pros." Obviously, since the pros have been heavy sellers all through 1980, the old adage did not work – this time. Incidentally, this study (member transactions) is part of the "character of the market" type of study. The category of market indicators which I always trust most is the "action of the market" category. This includes the Primary Trend Index. Of all the indices I have studied, the PTI is the one that is least likely to be deceptive or misleading.



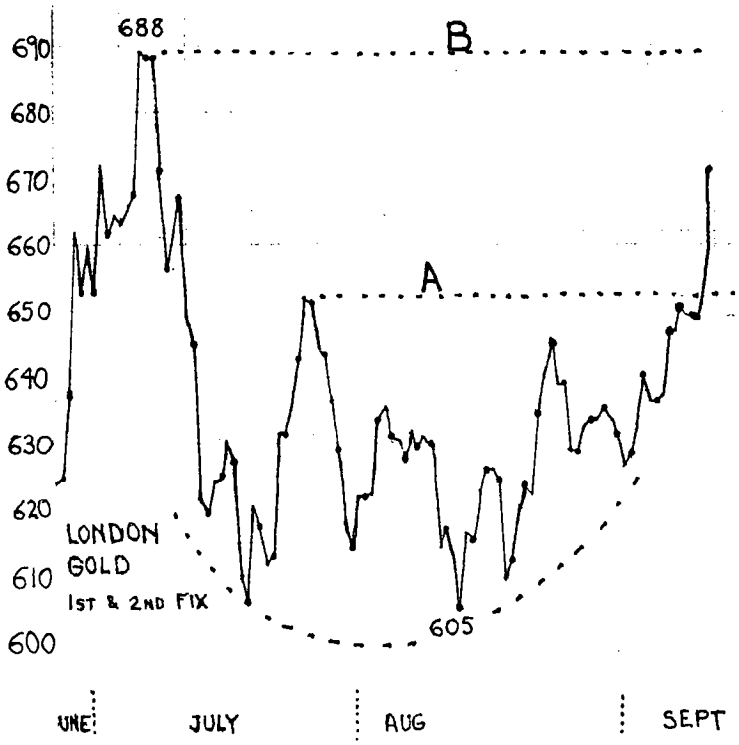
GOLD: I'll start this section with a personal opinion. I don't think Reagan is going to win. You know, when you wear a badly made shoe it bothers you at first and then you sort of get used to it. That's where I think the public is with Carter. He's a bad shoe, but they're used to him. And there are an awful lot of Democrats in the US.

I'll also venture the guess that gold senses a Carter victory, and it's up above 600 as it discounts the troubles that will come with another four years of Jimmy. Certainly international sentiment is anything but optimstic about a second term for the Carter family, and I suspect that there is a good deal of gold buying on the basis that four more years of Carter equals a major plus for the Russians, and a major plus for the Russians turns mens' minds to gold.

Second thought: gold is now super-sensitive to dollar strength or weakness. At the first sign of a drop in US interest rates (last week), the dollar turned weak- and gold turned strong. I would think that even the hint of a Fed attempt to lower interest rates would send gold flying – which is one of the reasons why the Fed

has not been a proponent of lower interest rates. They are simply not ready to face another run on the dollar.

The accompanying chart shows the daily gold action (first and second fix) from June to the present. Since mid-July, gold has traced out a good base, and it is now pushing very close to the first upside line of resistance at A. If A is bettered (above 652) the next resistance should occur at B in the 688 area. As I wrote in the last Letter, the more backing-and-filling, the more fluctuating in the 605 to 652 area, the stronger the base for gold.

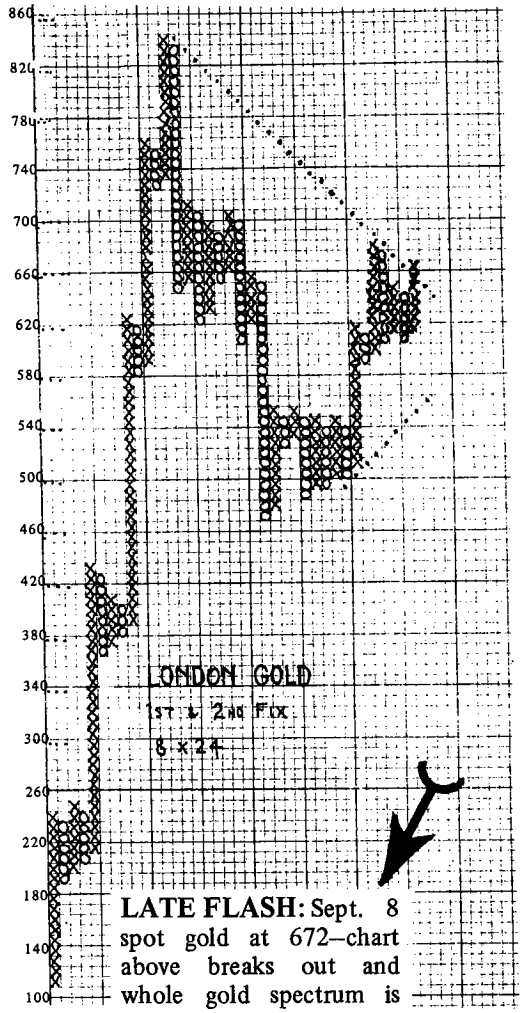


In the meantime the gold SHARES have taken off to new highs literally across the board. *United Services Gold Fund* and *International Investors* (both previously recommended) have spurted to record highs. The Canadian golds have dotted the high list, and undoubtedly a lot of money has gone into Canadian golds as a hedge against any trouble in S. Africa. But the important concept is this: the shares now act as if 600 is an absolute floor on gold.

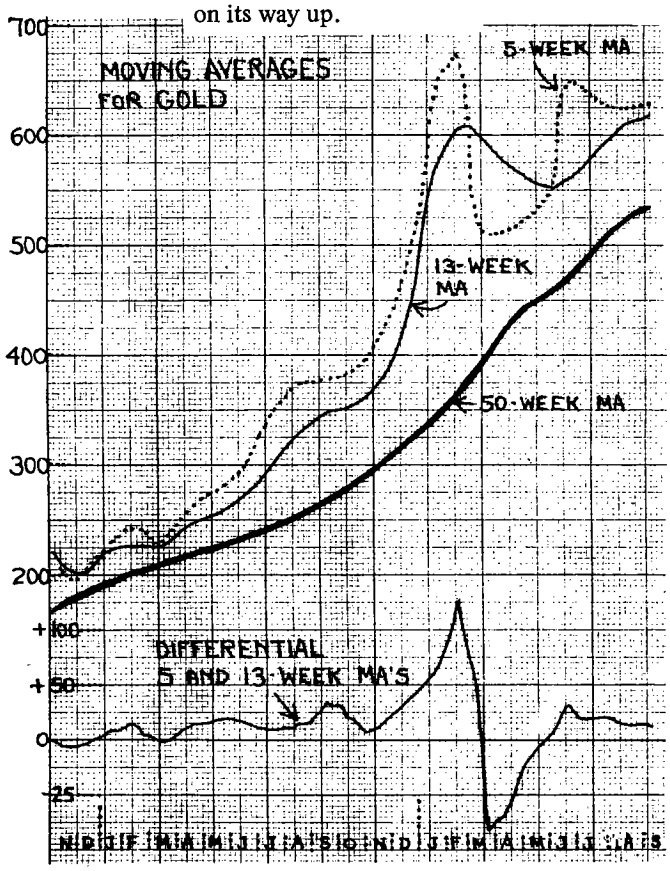
They act as if "600 plus" gold can be figured into their earnings. During July and most of August, investors did not believe that 600 would hold. They have obviously changed their mind (remember the big build-up in the short interest of the gold shares that I discussed, a build-up that has been going on ever since May! My comment was that the shorts do not trust these prices for the gold shares, and that the shorts would be wrong).

The point & figure chart for gold shows the metal riding just under the 1980 declining trendline (the major line of upside resistance). This chart tells us that a price of 668 will reverse the whole picture for gold and turn the metal strongly bullish. A price of 692 would set bullion up for an attack on the high.

Final gold study: the three (exponential) moving averages. Note that throughout this correction the 5-week MA refused to break below the 13-week MA, an impressive feat. Meanwhile, the (primary) 50-week MA last week recorded a record high of 538 (the 5-week MA was 634 and the 13-week MA was 621). And the final note:the prime rate has moved up to 12%. It pays to own a bank these days.



LATE FLASH: Sept. 8 spot gold at 672–chart above breaks out and whole gold spectrum is on its way up.



NEXT MAILING: September 24th